Commentary
2026 European Independent Power Sector Outlook: Growth With Challenges

Morningstar DBRS
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Key Highlights
- Electricity demand is expected to increase moderately, along with GDP growth, partially supported by mandates to electrification.
- There will be continued growth in renewable capacity, coupled with increased challenges from grid and permitting access.
- We expect increasing government support across the continent for energy-intensive industries dealing with high energy costs.

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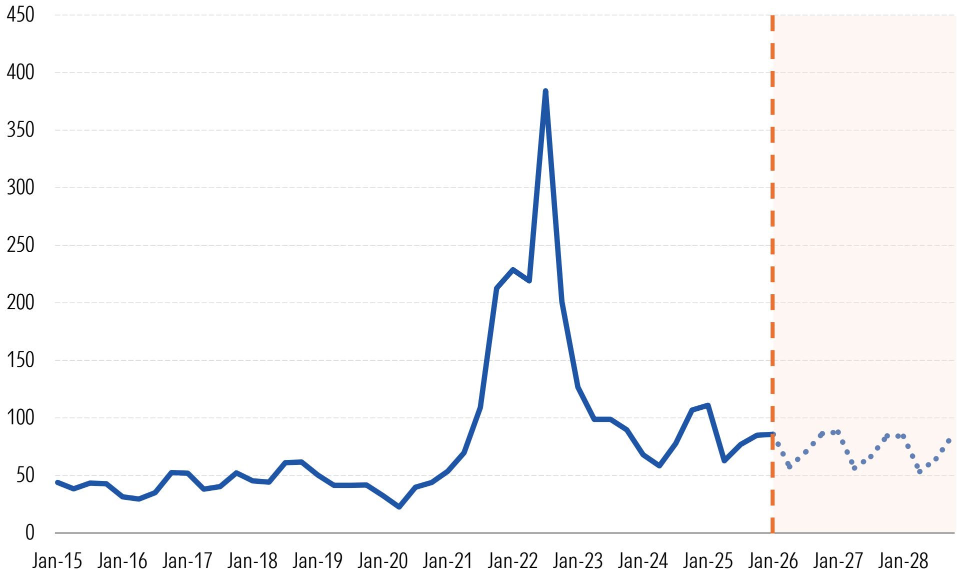
Overview
Our outlook is primarily based on our expectation that in 2026 power prices will remain largely in line with 2025 levels. We expect, electricity demand will increase modestly, along with GDP growth. This increased demand for electricity will also be upheld by cross-continental governmental support for power-intensive industries as well as their mandates to move away from fossil fuel consumption and towards electrification for heating and transportation. However, we expect electricity mandates will result in slower electricity demand than was initially forecast at the time they were put in place. Moreover, the electricity demand from conventional and artificial intelligence-optimized data centres will continue to increase significantly from current levels. Nevertheless, we do not expect demand from data centres to represent significantly higher than 2% of total electricity demand over the medium term.

In 2026, we expect European IPPs will continue to make progress at renewable energy projects. However, new projects will face greater challenges than in the recent past from grid connection access, permitting issues, and sufficient electricity prices. We also expect there to be increased interest in nuclear power plants in 2026, as development continues for new facilities, and governments look to decarbonize their electricity systems.

Morningstar DBRS' 2026 Credit Outlook
From a credit perspective, we do not expect changes in merchant electricity prices (see Exhibit 1) or total demand to have a material effect on our rated European IPP companies. Most investment-grade European IPPs that we rate have significant contracted portfolios and use rolling hedges to limit their exposure to changes in wholesale electricity prices for their uncontracted positions. We do expect that most of our rated IPPs will continue to cautiously develop and construct new renewable projects. We expect that many of these projects will be partially funded with debt that could constrain credit metrics; however, we expect most of our rated European IPPs to do so prudently.

Exhibit 1 Whole Electricity Prices (EUR Per Megawatt Hour)



Sources: ECB; Macrobond; Morningstar DBRS.

Keeping the Grid Stable

The high proportion of renewable generation capacity will allow IPPs with dispatchable generating capacity to continue to be able to capture higher than market power prices. We also expect electricity grid operators to increase focus on grid stability in 2026, to avoid a repeat of the Iberian Peninsula blackout that occurred in April 2025. We expect the increased focus on grid stability will also allow IPPs with dispatchable generation to be able to earn capacity and other ancillary revenues. We believe that IPPs with dispatchable hydroelectric capacity should especially benefit from this because of low marginal cost and zero carbon emissions.

Moreover, the increased attention on grid stability will keep nuclear power in focus in Spain for 2026. Spain's 2021 climate and energy plan looks at the full decommissioning of its seven nuclear reactors between 2027 and 2035. Spain's nuclear fleet generated approximately 20% of Spain's electricity in 2024. However, in October 2025, the owners of the Almaraz Nuclear Power Plant's Units I and II, which are scheduled to be decommissioned in 2027, have requested that their operating licenses be extended until 2030. In November 2025, an amendment to extend the closure dates of Spanish nuclear power plants was narrowly defeated in the Spanish congress, which voted 171 in favour and 171 against, which resulted in the amendment failing to pass. However, we expect that the conversation regarding the extension of nuclear power in Spain will continue through 2026 until the 2027 Spanish elections.

Government Subsidies to Support Industrial Electricity Demand

In 2026, we expect government support to help large European industrial companies with comparatively high electricity prices in Europe. Examples of this support include Germany's governing coalition's scheme, which was approved in 2025 to supports its large industrial customers. The scheme involves setting a price cap of EUR 50 per megawatt hour (MWh) for Germany's largest electricity customers. The scheme is scheduled to be in effect in January 2026 and to continue through 2028 with the subsidy funded by the Federal Republic of Germany.

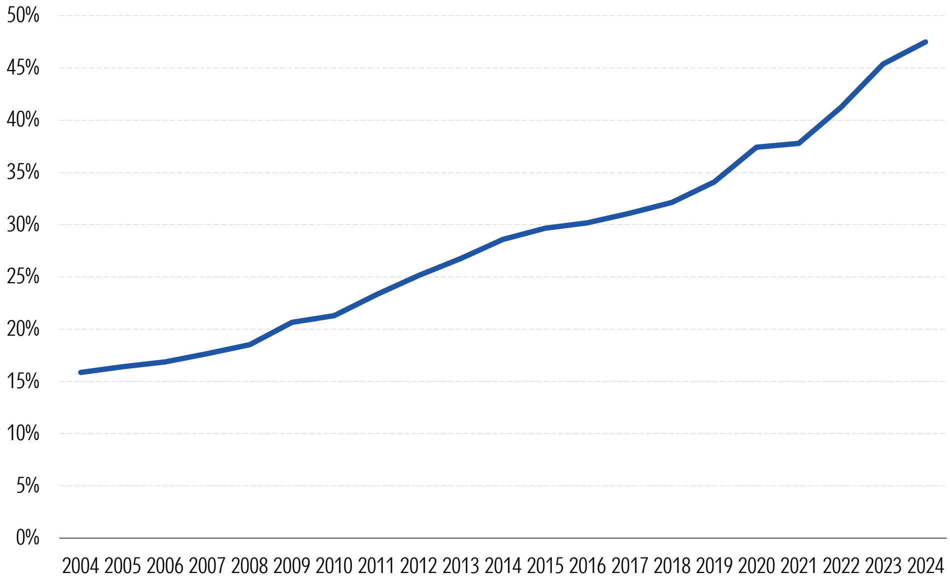
Spain will also support their own electricity intensive industries through subsidies to these companies. Total subsidies to these companies will increase to EUR 600 million in 2026, which is double the EUR 300 million subsidies that the Spain provided in 2024. The UK will also increase support for their energy-intensive industries, such as chemicals, steel, and ceramics by providing these companies with discounted electricity network charges. The discount for 2026 is expected to be from 60% to 90% starting in March 2026, which will result in additional savings of GBP 7 per MWh for these customers. This program is funded with a levy on electricity utilizers for nonenergy-intensive electricity utilizers.

These schemes and subsidies should remain in place over the medium term as both the EU and the UK continue with their energy transition. European energy demand should also benefit from these schemes as these subsidies will enable large electricity consumers to continue to operate and utilize electricity, rather than downsizing and offshoring power-intensive activities.

Continuing the Transition to Renewable Energy

We expect European IPPs to continue to make progress at increasing the proportional share of renewables in the energy mix (see Exhibit 2). The EU has made significant progress with the energy transition, increasing the proportion of renewable electricity generation to 48% in 2024 from 16% of total production in 2004. Although renewable energy has become a mature industry with significant expertise, we believe the development of these new renewable projects will be challenged with obtaining grid connection access and other permitting issues. We also expect new renewable projects to be challenged with the developers' ability to have sufficient power purchase agreement and merchant electricity prices to bring projects online. We believe that these challenges will make it more difficult for the EU and the United Kingdom to hit their net zero by 2050 electricity emission targets.

Exhibit 2 Share of Renewable Generation of Total Production in the European Union



Source: Eurostat.

Demand from Electrification Will Continue

Demand for electricity from mandated conversion to electrification, such as converting fossil fuels for building heating and for electric vehicles, will continue to grow. However, the growth will be more muted than was initially expected. For example, the rate of heat pump installations has been slower than expected and installations would have to increase by more than two times to meet the EU's initial heat pump targets. Demand from electric vehicles should also support electricity demand but the growth from this could decrease as the EU modified their target for 100% ban on petrol and diesel cars by 2035 to instead mandating a decrease in vehicle emission by 90%.

Growth in Offshore Wind Will Slow Amid Regulatory Challenges

Offshore wind in Europe will continue to grow in contrast with the United States where President Trump's executive orders in 2025 led to the cancellation of projects and developers writing off their U.S. offshore projects. However, European companies will be challenged to bring some of these projects online with the current support regimes in place. EU countries are targeting to have 88 gigawatts (GW) of offshore wind capacity online by 2030. Europe currently has 20 GW of installed capacity and achieving their target will be a challenge.

This challenge was demonstrated in 2025 with the cancellation of various offshore wind auctions because of a lack of sufficient bidders. For example, Germany had zero bidders for some its offshore wind auctions in 2025, the Netherlands received zero bids for the auction for 1 GW offshore wind project, and Lithuania cancelled an offshore wind project as the auction did not receive sufficient bidders. In 2026, we expect European governments will revise their guidelines or provide additional support for offshore wind projects by providing additional price guarantees or improving the contracts for differences (CFDs) pricing to make the projects more attractive to investors. For example, in 2025, France approved a EUR 11 billion scheme to provide CFDs to support the development of three floating offshore wind projects of 500 MW each, one off the coast of Brittany and two others in the Mediterranean over a 20-year period.

Nuclear Power will Become More Attractive, but Finding Funding Will Remain a Challenge

We expect there will be an increase in the development work of new nuclear capacity across the continent. In 2025, there was increased acceptance from Germany, which dropped their opposition to the French request for the EU to treat nuclear power generation on par with renewable projects. German Chancellor Friedrich Merz also outlined that his party could support the construction of new small modular reactor (SMR) plants.

Because nuclear generation has stable output, it can provide a stable base for a country's energy system. In 2026, we expect that there will be increased interest for countries to develop nuclear power in plants to meet their decarbonization goals while maintaining energy independence and grid stability. These benefits have been demonstrated by the Estonian government's approval of preparation work and site selection for a 600 MW facility composed of two 300 MW SMRs. The new facility would be a suitable replacement for baseload power generation for Estonia's current high-carbon emitting oil shale generating facilities.

However, because of the relative complexity of development and the high upfront cost and long lifecycle of the nuclear power generating facilities, we expect the development of new nuclear power generation facilities will require government support to be developed. For instance, in December 2025, the EU approved the Polish Government support plan for Poland's first nuclear power facility, which is expected to enter commercial operation in 2033. Poland's support for the project includes CFDs for 40 years along with equity injections and loan guarantees.

Another funding model for nuclear to assess in 2026 is construction of the UK's Sizewell C, 3.2 GW nuclear power station; the final investment decision for which was made in July 2025. Sizewell C will be the first nuclear power station in the UK that will be funded with a regulated asset base (RAB) model. The RAB model is like the funding model utilized across the world for regulated electric and gas utilities. The UK's Office of Gas and Electricity Markets, which will provide the owners with a regulated return on equity on their investment throughout both the project's construction and forecast 60-year operating phase. This funding model will lower the risk to both equity and debt investors into the project. The UK expects the RAB model will significantly lower the project's financing costs with the government estimating that the RAB model will save consumers GBP 30 billion over the project's life.

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